Where Are My Earnings? Quality of Earnings Analysis in Post-COVID-19 Urgent Care Transactions

Introduction

The COVID-19 pandemic sent shockwaves throughout the urgent care industry and fundamentally changed the business of urgent care centers (UCCs). At the start of the pandemic, UCCs had to quickly adapt to offer a new service line and meet the high demand for COVID tests. As the pandemic has progressed and evolved, UCCs have had to continue to adapt to address the effects of vaccination, variants, and at-home testing on their volumes. In addition to this, they have had to adjust to the changing landscape around reimbursement regarding government mandates on COVID testing and an increase in new patients. As the pandemic has evolved, the VMG Health Quality of Earnings team has been involved in urgent care transactions and has worked firsthand with our clients to quantify the effect of these changes on EBITDA.

COVID-19 History at Urgent Care Centers

Urgent care centers were at the forefront of treatment and testing services throughout the COVID-19 pandemic. After initial volume disruptions during the early onset of the pandemic, urgent care centers experienced significant increases in testing volumes and new patient visits. Average patient visits per clinic ("APVC") reached record highs during the summer of 2020 when UCCs ramped up testing capabilities and adopted telehealth services. Overall, UCCs with COVID-19 testing capabilities retained more volume than those without testing capabilities.

In addition to the increased visit volumes, the patient mix between new and established patients shifted. Prior to April 2020, the patient mix between established and new visits averaged approximately 60% established and 40% new patients. Following COVID spikes, new patient visits became a greater ratio of total visits and represented over 50% of the patient visit mix after April 2020 and into 2021. This mix shift had an impact on reimbursement for many urgent care centers. Clinics saw an increase of 52.0% in average net revenue per visit in 2020 as new patients were reimbursed at a higher rate than established patients. This was partially offset by a rise in "no-visit" patients where an E&M code was not billed (e.g., only testing services performed).

During January 2022, through funding from the American Rescue Plan, at-home COVID testing kits were offered online for free. As of May 2022, over 70 million households have visited COVIDTests.gov to order free at-home tests and 350 million tests have been delivered through the program. The program has offered several rounds of free at-home testing mailed through USPS, and eight additional tests were approved for distribution as of May 17, 2022. In addition, pharmacies, online stores, (e.g., Amazon), and retail locations have expanded the accessibility of at-home testing kits.

Volume-Related Quality of Earnings Adjustments

To quantify the impact of these trends on an urgent care center's quality of earnings, we must first distinguish between the three types of visits – asymptomatic COVID visit, symptomatic COVID visit, and traditional urgent care visit. Many UCCs now require an office visit whenever a COVID test is administered, therefore we cannot solely use CPT codes to separate between asymptomatic and symptomatic visits but instead must rely on the ICD-11 codes. Based on ICD-11 codes, asymptomatic COVID visits include patients who only have a COVID test code and, in some cases, a comorbidity code such as having high blood pressure, being a smoker, etc. Symptomatic COVID visits include both a COVID test code and symptom codes (i.e., cough, sneeze, sore throat, etc.). Finally, traditional UCC visits include all remaining visits. Once these visits have been categorized, we can begin adjusting to expected go-forward volumes.

First, we evaluate the appropriate run rate of asymptomatic COVID testing. At the start of the pandemic, few individuals received an asymptomatic COVID test since facilities often experienced shortages of tests and chose to prioritize symptomatic patients. In 2021, asymptomatic testing increased as individuals sought testing to

meet requirements imposed for travel, employment, and other reasons. Recently, asymptomatic testing demand has decreased as many cities, states, and countries have either eliminated testing requirements or replaced them with vaccine requirements. Due to the changing landscape of asymptomatic testing, we use a narrow time frame of three to six months to determine the appropriate run-rate volume.

Next, we determine the go-forward state of symptomatic COVID testing. Before the prevalence of vaccines, symptomatic COVID testing dominated UCC volume. At this time, the only downward pressure on volume came from supply shortages. After the widespread availability of vaccines in early 2021, UCCs began to experience periods of both high and low demand for symptomatic testing as new variants began to emerge. In addition to this more seasonal nature of demand, at-home testing became more prevalent and was further accelerated by the funding from the American Rescue Plan in January 2022. Based on all these factors, we use a look-back period of eight to 12 months for calculating the average go-forward volume. This timeframe ensures we capture seasonality while only including months with similar circumstances regarding vaccinations and at-home testing.

Finally, we evaluate the expected recovery of traditional urgent care volume. During the period of stay-at-home orders in 2020, UCCs saw a large fall in non-testing volume. This was especially prevalent as many facilities temporarily became COVID-only sites. After stay-at-home orders were lifted, facilities still saw lower non-testing volume due to other restrictions put in place such as mask mandates and social distancing. These restrictions resulted in a milder cold and flu season at the time. As traditional volumes remain depressed, 2019 represents the ideal benchmark for estimating future urgent care volume as it is the last year untouched by COVID.

However, relying on 2019 volumes to determine a new run rate comes with its own challenges stemming from capacity constraints, hiring challenges, and volume trends. In 2019, most UCCs were ideally operating close to full capacity with only traditional visits. Thus, we need to balance the expected COVID test volume with a return to normal to ensure we do not project total monthly volume beyond the capacity of a location. Additionally, many UCCs have reported hiring challenges due to the shortage of nurses and mid-level providers which make up the bulk of staff for most facilities. We address this challenge to our calculation by holding conversations with management to understand the specific facility's hiring challenges and to determine if traditional capacity needs to be reduced. Finally, as of April 2022, Experity reported that non-COVID visit volumes were only at 72% of pre-COVID levels. This trend means we cannot peg a complete return to pre-COVID levels because volumes have not recovered despite life returning to normal in many states. With all these challenges, we can no longer use 2019 as a benchmark since the landscape of urgent care volume mix has changed dramatically over the last two and a half years. As a result, we elect to use the average of the last six to eight months to capture seasonality and current trends. Although these volumes trend lower than 2019, they reflect the changing reality of the volume mix and capacity concerns.

Once we have determined go-forward monthly volumes for the three test types, we can make the appropriate quality of earnings adjustments. We begin by creating cash waterfalls for each volume type to calculate accrual basis revenue. Using this revenue, we calculate the historical average reimbursement for each visit type. Due to changing reimbursement trends for COVID testing and office visits in recent years, we use the average of the last six months in our calculation of adjusted revenue. Once we have determined the revenue adjustment, we

estimate the associated variable expense impact for each visit type based on common size percentages, direct allocation, and invoice review. Volume estimates are the key to the calculation of both the revenue and expense adjustments, which emphasizes the importance of reasonable estimates.

Additional COVID-Related Quality of Earnings Adjustments

Besides impacting urgent care volume and mix, COVID-19 also impacted the ramp-up of de novo facilities opened just before and during the pandemic. Average startup location volumes historically averaged between 10 to 20 visits per day in the first six months of operations for de novo locations opening between 2016 and 2019. Volumes for these locations stabilized at approximately 30 – 40 patients per day after 18 to 24 months. However, startup locations that opened in 2021 saw an average of 32 patients per day in the first month, and 60 visits per day after just six months. For quality of earnings analysis, the changes to the ramp-up of de novo facilities create a challenge for quantifying a run-rate adjustment. First, there are concerns about the sustainability of patient volume as COVID testing declines. At the beginning of the pandemic, shortages of tests meant individuals sought tests wherever possible even if it meant traveling to a further center. Some parent companies even made de novo locations into COVID-only sites to raise awareness of the new location. As a result, some patients may return to a different location for future visits which creates uncertainty when estimating the impact of a return of traditional urgent care volume. To combat this challenge, we engage in discussions with management to identify existing sites that serve a similar demographic and can be used as the volume being averaged to calculate run-rate.

The case mix changes also cause issues in conducting a revenue hindsight analysis. Due to government mandates around reimbursement for COVID testing, UCCs experienced higher reimbursements for patients getting a COVID test since many payors were obligated to pay all claims. Additionally, many COVID tests were administered either with no office visit or with an office visit of a lower E&M code level than typical. Furthermore, UCCs that did require an office visit often saw new patient visits becoming a greater ratio of total visits following COVID spikes, and new patients represented over 50% of the patient visit mix after April 2020 and into 2021. This patient mix shift drove an increase in average net revenue per visit for many UCCs. Finally, stay-at-home orders and people working from home have driven a slowdown in reimbursements from payors. As a result, historical collection trends were skewed during 2020 and into 2021. All these factors necessitate a close analysis of the revenue data for UCCs which often entails performing separate analyses by visit type (i.e., test vs. non-test) or CPT code (i.e., new patient vs. established). Due to the changing landscape of patient and visit type mix since the beginning of the pandemic, the revenue hindsight analysis has become a large area of focus for all parties to the transaction.

Typically, the last, most straightforward adjustments we perform in our analysis center are on non-recurring COVID revenue and expenses such as CARES Act funding and rent abatement. Many UCCs participated in the various economic relief programs and received Paycheck Protection Program (PPP) loans, HHS stimulus grants, Economic Injury Disaster Loans (EIDL), etc. As these amounts were received or forgiven, many UCCs recognized the amounts as income. Additionally, UCCs often took advantage of temporary rent or payroll tax abatements that were recaptured or will be recaptured later. These amounts represent non-recurring or temporary measures, and we always include adjustments to eliminate their impact on earnings.

Conclusion

With all these complications and uncertainties arising from COVID testing, both buyers and sellers in the UCC market need to engage a quality of earnings team for their transactions. Over the last two and a half years, the outlook of COVID and testing has changed week to week and month-to-month. In 2021, our team was engaged as a sell-side advisor and conducted an original analysis in addition to two roll forwards for one client. Each of our analyses was at a different point in 2021 and each analysis had unique trends around vaccination, variants, and seasonality. By engaging a quality of earnings team, our client was able to get a deeper analysis of its earnings to quantify the effects of this changing landscape on its EBITDA. From the expansion of at-home testing to the potentially permanent depression of traditional volume, quality of earnings will be crucial in analyzing the changing nature of the COVID and UCC landscape as we continue to return to normal.

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